A Proposed Partnership: Banks and Government in Disaster Lending

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Presented at

The Financial Services Roundtable

2007 Spring Meeting

April 26, 2007

Boca Raton, Fla.

Thank you, Tom, for the gracious introduction and for having me here. It's great to be here speaking to such a distinguished group that is so critical to the mission of the SBA. I am very grateful for the opportunity to come and explore opportunities for cooperation between the federal government and the lending industry, especially on an issue as complex and essential as disaster response and economic recovery. I have actually spent most of my career one side or the other of the financial services industry. I started at FNBC out of college, went to Lehman after business school, became Treasurer of First Data where we were very active in capital markets, and then became a CFO.

The SBA is at a crossroads. We have addressed many of the short-term issues facing our agency, but there are long-term issues that need more enduring solutions. One of these solutions is a partnership between the SBA and the nation's lenders in disaster response and relief. I asked for the time to speak with you today so I could ask for your ongoing assistance and involvement as we craft solutions that will carry our nation forward.

I am impressed by the efforts and commitment you have made to disaster relief. I found the session earlier regarding catastrophe response very interesting, and commend your approach to this important issue. After 24 years in business, I took over SBA about nine months ago, and did so with a desire to make wholesale changes in the way we handled disaster relief. Alongside millions of Americans, I had watched in horror as the tragedy of

Hurricane Katrina unfolded, feeling frustrated, feeling that giving money and praying was somehow an insufficient contribution. Many shared this feeling.

As Administrator, I'm afforded a chance to make a direct impact on the face of American disaster relief and response. I feel fortunate for this opportunity, as I'm sure many of you do as well and carry the same sense of calling.

The Gulf Coast Hurricanes overwhelmed us all. As the federal government's provider of long-term, low-interest disaster loans to homeowners and businesses, SBA was faced with over 420,000 applications in 2005— by far the most in our history. The result was a taxed system that left both businesses and homeowners without the timely availability of capital necessary to get their businesses back up and running and their families back in their homes. Looking forward, we need to be prepared for the worst, even as we hope for the best.

When I came to the SBA, 11 months after Katrina, although the agency had expanded its staff and systems capacity, many of its underlying processes were seriously flawed. As a result, 120,000 loans, 3/4 of all approvals, were still somewhere in our process. I kicked off a very extensive process reengineering initiative with job #1 being to accelerate disbursements on approved loans. We focused on reducing errors and rework streamlining processes, improving controls, and becoming more responsive and helpful to our borrowers. Within months, the backlogs were eliminated and 98% of the approved borrowers had received all or part of their funds or withdrawn their requests.

Today, over 5.5 billion dollars is in the hands of disaster victims. We have also made great progress improving the front end of the process, and have prepared a comprehensive disaster playbook that will soon be public, and will outline how SBA plans to use state-of-the-art technology, surge models and a variety of other mechanisms to meet the needs of catastrophic disaster victims.

Today the SBA is much more prepared to deal with a Katrina-sized disaster event -- or even much larger -- and I am proud of how many lives we've helped get back on track in the Gulf.

However, we are not yet where we need to be.

- We continue to face IT limitations.
- We need to find viable staffing sources that can ramp up quickly
- And because we operate a model which flexes based on demand, the larger the disaster, the more difficult it becomes to hire up, train up, and run a high-quality operation. In other words, we need to find a solution beyond what we can provide in-house.

I see greater cooperation between lenders and government as the most logical and effective credit alternative for improving the nation's disaster relief – both immediate response and long-term recovery – and I know there are examples of partnership in the past. But by being more thoughtful in creating the best mechanisms to do that ahead of a major disaster, we will be better equipped to get money into people's hands sooner after a disaster occurs, and do so in a way that meets their needs. Speed of response is the most critical factor to getting people back into their communities and employers back on their feet.

As you may know, there are disaster relief bills before the Senate and the House right now. As I see it, there are two primary ways for us to partner with the private sector in a major catastrophic event:

1. Outsource all or a portion of the loan processing to a third party while the SBA remains in the role of the lender.
2. Structure one or more disaster loan products to be provided by the private sector.

The House bill looks to banks for operational support in processing loans; the Senate bill looks to bank to make heavily guaranteed disaster loans with an interest rate buy-down. In theory, both have compelling elements. In the House solution, I am concerned with the capacity of any one institution to take on our processing load and the reputational risk to them. On the other hand, I have a hard time imagining how we would manage multiple institutions.

With the Senate solution, I have concerns about the cost, both to the tax payer and the borrower as it's currently structured.

I have urged lawmakers to devise a plan that will get adoption by banks. I want to know that the answer is yes to the question, "If we build it, will they come?" Unless it is embraced by the people in this room and you all sign up for the program, we in Washington will have failed to put forward a viable solution to address our most devastating disasters.

We plan to work with both houses of Congress, as well as with the White House to contribute to the proposed legislation. I have already put forward my own thoughts on what I think is important. What we need from the lenders in this room is your best thinking about what structures would be adopted by the industry, and work to get those thoughts in the ultimate product. Our goal is to get people and businesses back on their feet faster, which will

- reduce business failure rates,
- increase economic activity, and
- accelerate rebuilding in the aftermath of a major catastrophe.

In doing so, response time, cost, and sensitivity to the borrower are all factors we need to consider. We also need to consider that the lender community has many different kinds of players, and what works for one may not work for another.

In the conversations we've had with community banks, they've made it known to us very strongly that they want to be involved in disaster relief and recovery operations. These banks have a vested interest in the welfare of their communities and so their desire to quickly process loans and get money into the hands of their residents and businesses is understandable—their future is tied directly to the swift economic recovery of their communities. The community banks may not be able to handle the load of a Katrina-sized (or larger) event on their own. In addition, many of the nation's larger lenders already have streamlined mechanisms in place with the SBA, which may be able to be leveraged.

Private lenders have inherent advantages over the SBA in times of disaster that cannot be easily replicated. They are physically located in disaster areas and people know where you are. They are a destination for disaster victims, a place of security. They know their communities and have existing relationships and trust built with customers. When an earthquake happens, it's much more plausible that an individual is going to go to their lender for support than they are to an SBA disaster center. Most people don't realize we make disaster loans at all, much less to homeowners, although we are making progress.

As I have thought about what would work, it seems to me that there are a handful of principles we need to consider if it is to be attractive to the private sector:

1. It needs to be a relatively simple process
2. Compliance issues need to be relatively clear and straight-forward
3. There needs to be a profit in it for the provider, while <u>not</u> being to costly to the borrower or the tax payer.
4. There needs to be capacity for the potential demand.
5. We need to mitigate the potential for subsequent Congressional/media criticism.

You all have capacity, reputational and financial issues that need to inform this process. You all may not be concerned about some of these issues or you may have others. We certainly need to understand them.

I should also emphasize that a partnership does not have to be a wholesale solution. There are of ways in which we can work together in more limited ways, which may minimize some of the pitfalls of the more ambitious proposals while maximizing the benefits. My goal is to design the most viable and valuable partnership between banks and the SBA, thereby establishing the framework of a cooperation that will continue to grow over time.

There is a final way in which we see the banks and SBA working together and that is by leveraging the capital markets as we work to respond to disasters. By doing so, we may be able to diversify the risk and add flexibility to the number of financial instruments that can be brought to bear on a catastrophic event.

In pursuing this concept, my staff has been reviewing private sector use of catastrophe bonds in the insurance industry as a possible model to provide additional security to businesses and municipalities in the face of catastrophic events. Further, in cooperation with the Government Financial Officers Association, we will be hosting a working session involving credit agencies, underwriters (including some from the banks here today) and bond council, to explore possible financial structures that might develop in the utilization of such instruments.

My staff, with the assistance of the Financial Services Roundtable, will be reaching out to your staffs in hopes of advancing the cooperation and creating forward-thinking, positive advances in our disaster relief effectiveness.

Let me move on briefly to a couple of other topics I would like to engage you on. First, guaranteed loans to small business. We have an overall portfolio of direct and guaranteed loans of about $80 billion. Over half of that portfolio is our 7(a) portfolio, which are guarantees that back loans that you all make. The SBA has long worked with the lenders of this country, and together we've accomplished some great things. We've been guaranteeing loans made by commercial lenders since 1954, and by now we have more than 5,000 lenders who make various types of 7(a) loans.

Some of these are great products that do a lot of good. However, they are not all terribly easy for lenders to use, and I believe it is impairing our ability to get capital into the hands of people we are trying to reach.

We need simpler operational processes that encourage lenders to market our products. In the last few years, we've set records every year, with last year's number topping 97,000 loans. It's no surprise to anyone that, as we look at our statistics, SBA's loan growth is heavily driven by those products that are easiest to use. They are also smaller products, so our average loan size is declining. We can't expect either lenders or our customers to adopt a Byzantine process, even if the process is good.

We are focusing on increasing the degree of automation between us and the lenders, updating and simplifying our SOPs, and being much more responsive and transparent at the back end when we make good on guarantees. We are hoping that by doing so, we will expand your use of our products and thereby expand capital for small business.

My last issue is one looking at our core mission. I believe the SBA can make a much greater impact on our country by being more effective in helping capital to reach areas of our country with higher unemployment and poverty rates. We call them Underserved Markets, and they are generally located in our inner city and rural areas. I, like the President, am a believer in the ownership society and the generation-shaping impact that economic growth can have in our nation's most troubled areas.

The federal government has made some strong advances to encourage corporate attention to underserved communities. The New Markets Tax Credits program, for example, has supported construction initiatives. We have also have a number of programs that we need to expand.

The nation's financial institutions have also done wonderful things for underserved markets. From multi-lingual educational programs to mobile banking stations; from credit counseling to investment programs that focus on the most impoverished of communities, I have been struck by the efforts toward underserved markets. You all know your communities. You all know how to reach them. I think there is a great opportunity for us to work together more intentionally in underserved markets, because we have products that can help you stretch further…and many of you use them today.

Driving successful and sustainable business formation into underserved markets can absolutely CHANGE THE GAME for millions of Americans. Small businesses take risks that others won't take. Their founders match every dollar they invest with ten dollars of sweat equity and that is something that the SBA needs to do. And as those businesses form, they bring new jobs, economic activity, and structural investment to places that need it the most.

As we move in this direction, we are focusing heavily on lending products and outreach, as well as training and counseling, and possibly equity investment programs.

Thank you, once again, for the work you all are doing to address the issues we have with disaster recovery and to partner with us more broadly in serving America's small business community. I am thankful for that partnership, and I think we will be doing a lot over the next couple of years to make it stronger and more effective.